United States Court of Appeals

for the Second Circuit

APPELLANT'S BRIEF

74-2023

To be argued by
HOBART L. BRINSMADE

United States Court of Appeals

FOR THE SECOND CIRCUIT

SECURITIES & EXCHANGE COMMISSION,

Plaintiff-Appellee,

against,

CAPITAL COUNSELLORS, INC., CAPITAL ADVISORS, INC., J. IRVING WEISS, ABRAHAM B. WEISS,

Defendants.

CONBOY, HEWITT, O'BRIEN & BOARDMAN,

Appellant,

SYDNEY B. WERTHEIMER,

Receiver-Appellee.

On Appeal from the United States District Court for the Southern District of New York

BRIEF OF CONBOY, HEWITT, O'BRIEN & BOARDMAN, APPELLANT

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TABLE OF CONTENTS

Cases Cited

Statute Cited

Other Authority Cited

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Statement

This is an Appeal (pp. 70-72)* from an Opinion and Order of the United States District Court for the Southern District of New York (Cooper, J.) (pp. 65-70), denying an application of Conboy, Hewitt, O'Brien & Boardman (the "Appellant-Attorneys") (p. 33) that its claims for legal services rendered to the Defendants Capital Counsellors, Inc. and Capital Advisors, Inc. (the "Corporate Defendants") be allowed as preferred claims in the Equitable Receivership of the Corporate Defendants.

Proceedings Below

In December 1970 the Securities & Exchange Commission commenced an investigation as to whether the Corporate Defendants had violated various sections of law involving securities (p. 35). At that time, the Corporate Defendants retained the Appellant-Attorneys to represent them in such investigation and in any proceeding brought by the Securities & Exchange Commission as a result thereof and agreed to pay the Appellant-Attorneys the reasonable value of such services (pp. 34, 59).

Testimony of the Corporate Defendants was taken in December 1970 and January 1971 by the Securities & Exchange Commission (p. 35). As part of the investigation each defendant was advised that "under the Commission's practice, you have a right to be represented by counsel of your own choosing" (pp. 43-46). Appellant-Attorneys represented the Corporate Defendants in the exericse of this right in accordance with their retainer agreement (p. 35).

On March 25, 1971 the Securities & Exchange Commission instituted this action for the issuance of an injunc-

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* References are to pages of the Appendix.

tion restraining defendants from marketing securities and for the appointment of a receiver (p. 4). Contemporaneously the Court entered a temporary restraining order enjoining the Corporate Defendants from any transfer of their assets (p. 4). On April 2, 1971 this order was modified to allow the corporate defendants to continue operation of certain segments of their businesses and was further modified by orders of April 8 and May 7, 1971 for the same purpose (pp. 4-5).

The action was tried on May 12, 13, 14, 17, 18, 19 and 21, 1971, the Corporate Defendants being represented by Appellant-Attorneys as provided in their retainer agreement (p. 37). On June 11, 1971 the Court rendered its opinion in favor of the plaintiff (pp. 3-30) and entered an order appointing a receiver of both the Corporate Defendants (p. 1).

The application for attorneys' fees was made by Notice of Motion dated October 25, 1971 (p. 31).

Appellant-Attorneys were directed on December 21, 1971 (p. 62) to declare in writing the allocation of their services and time (a) between the period prior to March 27, 1971, and the period subsequent thereto and (b) as to the period subsequent to March 27, the services rendered to the Corporate-Defendants, individual defendants and individual witnesses (p. 62).

This direction was complied with in a letter to the District Judge dated January 4, 1972 (pp. 63-64) and argument was held and briefs filed on January 11, 1972 (pp. 2, 12).

On July 22, 1974 the Court held (p. 70) that "although the professional services rendered were of high order and deserving of the legal fees requested, the cost of the opposition interposed cannot be paid out of the receivership estate." The Court cited (p. 66-67) *Securities & Exchange*

Com'n v. *Alan F. Hughes, Inc.* (2d Cir.) 481 F.2d 401, argued May 29, 1973 and decided June 21, 1973, as resolving the application. This Appeal is from this holding.

Question Presented

Whether a District Court has power, in its discretion, to allow in an equitable receivership a preferred or general claim based on legal services contracted for and rendered by attorneys for the corporation prior to the receivership in opposing the appointment of the receiver.

POINT I

Attorneys' fees for opposing an equitable receivership are normally payable out of the receivership estate.

For at least ninety years the Courts have held that attorneys' fees contracted for prior to an equitable receivership and rendered in opposing the appointment of the receiver are payable out of the receivership estate in the discretion of the District Court. *Barnes* v. *Newcomb,* 89 N.Y. 108 (1882); *People* v. *Commercial Alliance L. Ins. Co.,* 148 N.Y. 563 (1896); *Robinson* v. *Mutual Reserve Life Ins. Co.* (C.C. S.D.N.Y. 1909) 175 Fed. 624, 627; 182 Fed. 850, 856 (C.C. S.D.N.Y. 1910) aff'd 189 Fed. 347 (2d Cir. 1911). See also *Godley* v. *Crandall & Godley Co.,* 181 App. Div. 75, aff'd 227 N.Y. 656; *Pickrel, Schaeffer & Ebeling* v. *Merion, et al.,* 66 N.E.2d 273 (Court of Appeals of Ohio 1943); *Lumbermen's Insurance Corporation* v. *State,* 364 S.W.2d 429 (Court of Civil Appeals of Texas 1963); 89 ALR 1531 (note).

Indeed, neither in the briefs submitted nor in the argument held on January 11, 1972, was it disputed that this

was the rule in equitable receiverships. The receiver submitted an affidavit (pp. 60-61) supporting the application as follows (p. 61):

> "It would be an injustice not to permit such corporations adequately to defend themselves, albeit the charges are ultimately sustained and a receiver is appointed for their assets. It would be difficult for corporations thus charged to obtain competent counsel unless the lafter are assured of being paid regardless of the outcome. The fact that the corporations are ultimately found guilty of the charges may properly enter into valuation of the attorneys' services, and therefore, warrant a lesser amount than would be payable if the corporations be successful, but, in my opinion, should not preclude all payment."

The Securities & Exchange Commission argued (pp. 43-46) that in view of the representation of the officers and employees of the Corporate Defendants "the staff cannot ascertain which portion of the total fees claimed *should be allowed to petitioner as general creditors.*" (p. 46) (Italics added) The Commission further argued that it was its "understanding" that the Appellant-Attorneys had agreed to receive their legal fees from the individual defendants as of March 25, 1971. (p. 47) This "understanding" was refuted by the reply affidavits (pp. 50-60).

However, the rule that in an equitable receivership the District Court has discretion to allow a claim for attorneys' services contracted for and rendered in opposition to the receivership was not contested.

Equitable receiverships, unlike bankruptcies, are not creatures of statute but have been evolved by the Courts over the years as an equitable remedy. Receiverships are not mentioned in the Securities Act of 1933, the Securities

Exchange Act of 1934 nor the Investment Advisers Act of 1940 under which this action was instituted. The relief was requested as an adjunct to the request for injunction. (See *S.E.C.* v. *H. S. Simmons & Co.,* 190 F.Supp. 432 (S.D.N.Y. 1961) cited by District Court (p. 30).

The rule allowing the District Court to allow contract claims for services rendered in opposition to an injunction and the appointment of an equitable receiver is based on sound doctrines of equity and fairness.

(a) As stated by the Receiver (p. 61) it permits corporations to obtain competent counsel to defend themselves. Without such a rule corporations, where assets are frozen (as in this case), would have to retain counsel on a contingent basis. This would render the fee high and onerous if they were successful. Or they would have to anticipate in advance and obtain payment for services to be rendered without knowing the value thereof. The fact that defendants "suffered no deprivation of legal services" in this case (see p. 67), does not establish that such deprivation will not result in the future to similarly situated corporations if this Court should change the rule that fees are compensable in the discretion of the District Court to a rule that fees are only compensable if no receiver is appointed.

(b) A contract for legal services entered into with a corporate defendant acting through its duly authorized representatives should be honored by a receiver. In this case the retainer agreement was made in December 1970 (p. 59). The action was not brought until March 1971 and the receiver was not appointed until June 1971. Presumably, the receiver has recognized all other contract claims of the debtor incurred before the receivership. To single out and reject attorneys' claims for services under an authorized contract merely because the services ren-

dered pursuant to such contract were furnished in opposing the appointment of a receiver, would seem to be arbitrary, discriminatory and unfair.

(c) The discretion of the District Court should be exercised to prevent the allowance of claims for services which the Court finds captious, delaying, interposed in bad faith, or unnecessary. However, the discretion of the District Court should not be exercised to disallow the fees because the corporations had been guilty of fraudulent conduct with which the attorneys are not connected. The Court should also take into account the extent of the burden imposed on the state and the usefulness of the services to the Court in deciding the issues raised by the parties.

In short, the long established rule of equity as to the allowance of claims for attorneys' fees for opposing an injunction and equitable receivership is fair and just and should not be changed.

POINT II

_S.E.C._ v. _Alan F. Hughes, Inc._ (_supra_) does not resolve the issue here raised.

_S.E.C._ v. _Hughes_ (_supra_) was an action to appoint a trustee brought under the Investor Protection Corporation Act of 1970 (15 U.S.C. 78 aaa et seq.) (hereafter "1970 Act") which provides for the liquidation of brokerage firms and the advance of Security Investor Protection Corporation funds in connection with such liquidation. The Act specifically provides (15 U.S.C. 78fff(c)(1)) that

> ". . . a liquidation proceeding [thereunder] shall be conducted in accordance with, and as though it were

> being conducted under, the provisions of chapter X and such of the provisions (other than section 96 (e) of Title 11) of chapters I to VII, inclusive, of the Bankruptcy Act as section 502 of Title 11 would make applicable if an order of the court had been entered directing that bankruptcy be proceeded with pursuant to the provisions of such chapters I to VII, inclusive; . . ."

The attorneys who had opposed the application for the appointment of a trustee in liquidation applied for fees to be paid out of the corporate estate. The issue to be determined (as stated in Appellee's brief) pp. 1-2, was:

> "Whether under either the Bankruptcy Act or the Securities Investor Protection Act of 1970 ("1970 Act") 15 U.S.C. § 78aaa et seq.) the defendants' attorneys are entitled to be compensated from the debtor's estate or funds of the Securities Investor Protection Corporation ("SIPC") for services rendered to the defendants in their unsuccessful efforts to defeat this liquidation under the 1970 Act."

Additionally, the Appellant argued that as far as the 1970 Act failed to provide for payment of reasonable attorneys' fees incurred in the defense of the action it was unconstitutional as a denial of due process and equal protection of the law.

Since the proceedings were purely statutory no argument was made as to the fairness of the rule (as opposed to its constitutionality) and none of the cases cited herein in connection with equity receiverships were cited in that case by either side. The argument was confined to interpreting the 1970 Act and the Bankruptcy Act and determining their constitutionality.

The provisions of the 1970 Act and the Bankruptcy Act have no relevancy on this appeal. This equitable receivership is not governed by statute but by the long established rules of equity. The fact that Congress has failed to provide that attorneys' fees for opposing liquidations under either the Security Act or the 1970 Act (to which public funds are contributed) are compensable, should not be a reason for annulling the long standing rule of equity in equity receiverships which permits their allowance as general or preferred claims in the sound discretion of the Court.

To apply a statute to a proceeding to which Congress never intended it to apply would be a dangerous precedent, especially in equity proceedings. Congress no doubt has the power to provide that attorneys' fees are not payable in equitable receiverships but it has not done so. Even if it did so, it would not be retroactive so as to affect services rendered prior to such enactment. Indeed, the application in the *Hughes* case and the decision of the District Court and its affirmance were all made after the services herein had been rendered and payment for the same applied for.

Nor does the holding in *Hughes* that the 1970 Act is not unconstitutional as far as it denies payment of attorneys' fees rendered in opposing a trusteeship thereunder establish that the rule of equity permitting such fees to be allowed in the discretion of the Court in equitable receiverships is unfair, unjust or should be abolished. The equities in favor of such rule, as set forth in Point I, *supra* (pp. 6-7) clearly are in favor of allowing such fees. Many statutes which are constitutional contain provisions which if left to a court of equity might not be adopted. Moreover, in view of the long application of the rule and the fact that the services were contracted for and rendered

before *Hughes* and before there was any indication that the rule would be changed, it would be manifestly unfair to now change the rule and deny Appellant-Attorneys all compensation.

POINT III

The District Court did not deny the application as a matter of discretion but because it held it lacked power to grant it.

The only assessment the District Court made as to the value of Appellant-Attorneys' services was that they "were of high order and deserving of the legal fees requested" (p. 70). Nevertheless it denied the application because "the issue here raised is resolved by the application of the reasoning in a recent decision, *S E C* v. *Alan F. Hughes, Inc.*" (pp. 66-67). The District Court stated that "though it could so provide" Congress had not in fact authorized the payment of fees for opposing the trusteeship under the 1970 Act. The District Court stated that this "Court found a compelling analogy to the Bankruptcy Act," but failed to observe that the 1970 Act incorporated the Bankruptcy Act into the 1970 Act by reference (15 U.S.C. 78fff(c)(1)). Neither Act is by its terms or by implication applicable to equitable receiverships.

The Court then reasoned (p. 68) that applicants' fees should be disallowed because the Defendant Corporations not only "were failing to meet their customer obligations but also because that failure resulted from fraudulent acts perpetrated by defendants." The Court did not find that Appellant-Attorneys were involved in any way in these acts, but reasoned that if Defendant Corporations were guilty of fraud, Appellant-Attorneys (even if not connected therewith) should be punished by not receiving

legal fees of which they were deserving. This reasoning, if applied to a criminal case would reduce the fees of defendants' attorneys based on the seriousness of the crime which they defended. Clearly, the Courts have never applied such an inequitable rule.

The District Court then cites certain sections of the Securities Act of 1933 and the Securities Exchange Act of 1934 allowing compensation and costs to litigants in certain situations. As the Securities Laws do not contain any provision for receiverships, the relevancy of such statutes to the case at bar is questionable. Clearly none of these cases cited by the District Court hold that a defendant is not liable for services contracted for and rendered if the services are not successful. They are limited to providing for compensation to the defendant from the plaintiff. They do not deal with the liability of defendant or defendant's own assets for services incurred by contract.

CONCLUSION

The case should be remanded to the District Court to decide in its discretion whether appellant-attorneys are entitled to any claim against the receivership estate and the nature of such claim.

Respectfully submitted,

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Services of three [3] copies of
the within brief is
hereby admitted this 8th day
of October, 1974

Leon Leighton

Attorney for Sydney B. Lewis

Services of three (3) copies of
the within is
hereby admitted this day
of , 197

Attorney for